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**Internal Revenue Service**

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# Determining the Value of Donated Property

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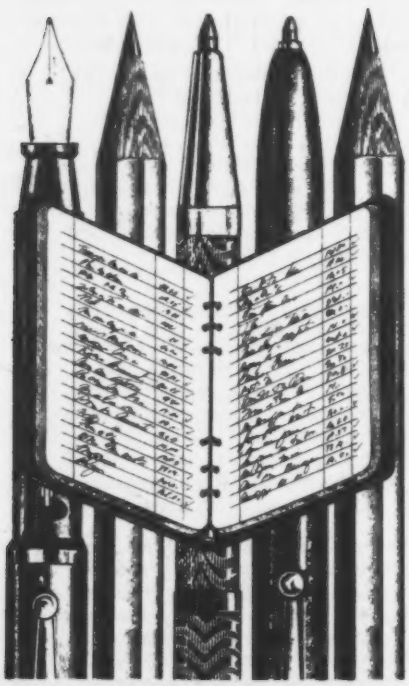

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## Introduction

You may take a charitable contribution deduction, under certain conditions, on your federal income tax return for genuine gifts of cash or property to qualified organizations. Property you lend or exchange is not deductible. To figure how much you may deduct for property that you contribute, you must first determine its ***fair market value.***

This publication is designed to help individuals and appraisers determine the value of property (other than cash) that is given to qualified organizations. It includes the kind of information you must have to support the charitable deduction you claim on your return.

For more information on charitable contributions (other than determining the fair market value), see Publication 526, *Charitable Contributions.*

## What Is Fair Market Value?

Fair market value generally is the price that the property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the facts. It takes into account many factors that affect the price of property on the ***valuation date.***

For example, if you give used clothing to the Salvation Army, the fair market value would be the price that typical buyers actually pay for clothing of this age, condition, style, and use. Usually such items are worth far less than what you paid for them.

In making and supporting the valuation of property given to a charitable organization, all factors bearing on its value that are relevant must be considered. These include the cost or selling price of the item, sales of comparable properties, replacement cost, opinions of experts, and the valuation date.

### Cost or Selling Price of the Donated Property

The cost of the property or the actual selling price may be the best indication of its fair market value. For this to be considered:

1) The purchase or sale must take place close to the valuation date in an open market,
2) The purchase or sale must be at "arm's length",
3) The buyer and seller must have known of all relevant facts,
4) The buyer and seller did not have to act, and
5) The market did not change between the date of sale and the valuation date.

***Example.*** Tom Morgan, who was not a dealer in gems, bought an assortment of gems for $5,000 from a promoter. The promoter claimed that the price was "wholesale" even though he and other dealers made similar sales at similar prices to other persons who were not dealers. The promoter said that if Tom kept the gems for over one year and then gave them to charity, Tom could claim a charitable deduction of $15,000, which, according to the promoter, would be the value of the gems at the time of contribution. Tom gave the gems to charity 13 months after buying them, and claimed a charitable deduction of $15,000.

The best evidence of fair market value depends on actual transactions and not on some artifical estimate. The $5,000 charged Tom and others ie. therefore, the best evidence of the maximum fair market value of the gems.

**The purchase or sale should be reasonably close to the valuation date.** Because conditions in the market change, the cost or selling price of property may have less weight if the property was not bought or sold reasonably close to the valuation date.

**The terms of the purchase or sale** should be considered in determining fair market value if they influenced the price.

**Unless you can show that there were unusual circumstances,** it is assumed that the increase or decrease in the value of your donated property from your cost has been at a reasonable rate. For time adjustments, an appraiser may consider published price indexes for information on general price trends, building costs, commodity costs, securities, and works of art sold at auction.

***Example.*** Bill Brown bought a painting for $10,000. Thirteen months later he gave it to an art museum, claiming a charitable deduction of $15,000 on his tax return. Bill should include with his return proof that there were unusual circumstances that justify a 50% increase in value for the 13 months he held the property.

**An arm's length offer to buy** the property close to the valuation date may help to prove its value if the person making the offer was willing and able to complete the transaction. To rely on an offer, you should be able to show proof of the offer and the specific amount to be paid. Offers to buy property, other than the donated item, will help to determine value if there is reasonable similarity to the donated property.

### Sales of Comparable Properties

The sales prices of properties similar to the donated property are often important in determining the fair market value. The weight to be given each sale depends on the following:

1) The degree of similarity between the property sold and the donated property.
2) The time of the sale— whether it was close to the valuation date.

3) The circumstances of the sale— whether it was at arm's length with a knowledgeable buyer and seller, with neither having to act.

4) The conditions of the market the sale was made in—whether unusually inflated or deflated.

See the discussion of *Comparable sales*, later under *Valuation of Various Kinds of Property*.

***Example.*** Mary Elm paid a promoter $10,000 for 500 copies of a single edition of a modern translation of the bible. The promoter had claimed that the price was considerably less than the "retail" price, and gave Mary a statement that they had a total retail value of $30,000. The promoter advised Mary that if she kept the bibles for more than 12 months and then gave them to a qualified organization, she could claim a charitable deduction for the "retail" price of $30,000. Thirteen months later Mary gave all the bibles to a church that she selected from a list provided by the promoter. At the time of her donation, wholesale dealers were selling similar quantities of bibles to the general public for $10,000.

The fair market value of the bibles is $10,000, the price at which similar quantities of bibles were being sold to others at the time of the contribution.

## Replacement Cost

The cost of buying, building, or manufacturing property similar to the donated item should be considered in determining fair market value. However, there should be a reasonable relationship between the replacement cost and the fair market value.

The replacement cost is the amount it would cost to replace the donated item on the valuation date. Often there is no relationship between the replacement cost and the fair market value. If the supply of the donated property is more or less than the demand for it, the replacement cost becomes less important.

To determine the replacement cost of the donated property, find the "estimated replacement cost new." Then subtract from this figure an amount for depreciation due to the physical condition and obsolescence of the donated property. You should be able to show the relationship between the replacement cost and the fair market value, as well as how you arrived at the "depreciated replacement cost new."

## Opinions of Experts

Generally, the weight given to an expert's opinion on matters such as the authenticity of a coin, a work of art, or the most profitable and best use of a piece of real estate, depends on the qualifications of the expert and the thoroughness with which the opinion is supported by facts. For an expert's opinion to be given full weight, the facts must serve to prove the opinion.

## Time of Contribution

It is important to determine the correct ***valuation date*** (the date of the contribution) because:

1) You must determine the value of your donated property as of that date, and

2) Generally, you must use the value of the property on that date in arriving at the amount of your contribution deduction. For certain exceptions, see *Valuation of Various Kinds of Property*.

Whether you use the cash or accrual method of accounting, the charitable deduction may be taken only in the tax year that the contribution is actually made. Under certain circumstances, an accrual method corporation may choose to deduct contributions that were not paid during the year if payment is made by the 15th day of the 3rd month following the close of the tax year. For more information, see Publication 542, *Tax Information on Corporations*. Ordinarily, the contribution is made when the transfer of the property takes place. But, see *Donating a Future Interest in Tangible Personal Property*, later in this publication.

**Stock.** If you deliver, without any conditions, a properly endorsed stock certificate to a qualified organization, or the organization's agent, the time of the contribution is the date of delivery. If the certificate was mailed and received through the regular mail, it is the date of mailing. If you deliver the certificate to a bank or broker acting as your agent, or to the issuing corporation or its agent, for transfer into the name of the organization, the time of the contribution is the date the stock is transferred on the books of the corporation. This, in effect, is the date of delivery to the organization.

## Reduction for Certain Interest

You must deduct from your contribution interest prepaid (or to be paid) by you on a loan secured by property that you give to a qualified organization. This is to avoid a double deduction, for interest and for a charitable contribution.

**The amount of the reduction** is the amount of interest that is for the loan assumed by the organization and that is for any period ***after*** the date of the contribution.

***Example.*** Ann Green, who uses the cash method of accounting, gave real estate with a fair market value of $10,000 to the local university. She held the property for 14 months and made the contribution on January 4, 1980. The university agreed to assume Ann's debt of $8,000. On January 2, 1980, she prepaid one year's interest of $800 on the debt and will take an interest deduction for that amount. The amount of the gift, before subtracting the prepaid interest, is $2,800 ($10,000 − $8,000, the debt, plus the $800 prepaid interest). To figure her charitable deduction, she must subtract the $800 interest deduction from the value of the gift ($2,800). Her contribution deduction is $2,000.

**Bonds.** You must subtract from the fair market value any interest paid (or to be paid) on money borrowed to buy or carry a bond, and that is for any period ***before*** the contribution. However, this reduction is limited to the interest (including bond discount and other items that are the same as interest) receivable on the bond that is for the period before the contribution and that you do not, because of your accounting method, have to include in your income for any tax year. As used here, the term "bond" means any bond, debenture, note, certificate, or other proof of debt.

## Gain or Loss from Contribution

Generally, the difference between the fair market value of property you donate to a qualified organization and your basis in the property does not result in a gain or loss.

***Example.*** You donate to your church stock with a fair market value of $10,000. Your basis in the stock is $20,000. You may not deduct the difference as a loss on your income tax return. In addition, your charitable deduction is limited to $10,000, the fair market value of the stock.

**Exceptions.** There are exceptions to the general rule, such as for property on which you had a gain or loss that you were not required to report. For example, a donation of an installment obligation to a qualified organization may result in a taxable gain or an allowable loss. See *Installment Obligations*, later.

Another exception is a "bargain sale." A bargain sale is a sale or exchange of property to a qualified organization at less than its fair market value, which results in a transaction that is part charitable contribution and part sale or exchange. A bargain sale may result in a taxable gain. For more information, see *Bargain sales to charity*, in Publication 526, *Charitable Contributions*.

## Gifts of Appreciated Property

If you donate property with a fair market value that is greater than your basis (generally your cost) in the property, you may have to subtract all or part of the appreciation from the fair market value when figuring your deduction. The amount of the reduction depends on whether the property is ordinary income property or capital gain property.

**Ordinary income property** is property that, if sold, would result in ordinary income or short-term capital gain. Examples of ordinary income property are inventory, a copyright, a literary, musical, or artistic composition given by the creating artist, certain letters and memorandums (discussed later under, *Letters and Memorandums*), and capital stock held one year or less.

***The deduction*** for a gift of ordinary income property is limited to the fair market value of the property minus the amount that would be ordinary income.



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***Example.*** You give to your church stock that you held for 3 months. The value of the stock is $1,000, but you paid only $800. Because the $200 would have been a short-term capital gain, your deduction is limited to $800.

If your acquisition and contribution activities are equivalent to the activities of a dealer buying and selling inventory, your donation is treated as ordinary income property (inventory).

Your contribution activities are equivalent to the selling activities of a dealer if you buy or produce property in bulk and distribute it to qualified organizations. Because this treatment applies ***only*** to charitable contributions, you are not considered to be carrying on a trade or business for any other purposes.

***Example 1.*** Lisa Baker, not a dealer in art, bought a substantial part of the total limited edition of a lithograph print by a well-known artist for $25,000. After holding the prints for 13 months, Lisa gave them to various art museums. The total fair market value of the prints was $100,000 when they were donated. Because of her bulk purchase and disposition of the prints, Lisa's activities are considered to be the same as those of a commercial art dealer. Her deduction is limited to $25,000 (the fair market value, $100,000, minus the amount that would be ordinary income if she had sold the prints, $75,000).

***Example 2.*** Tom Miller is not a dealer in books. Through a promoter, Tom bought 100 art books for $2,500, or $25 a book, from a company located in a foreign country. The retail price of $100 a book is legally fixed under the law of the foreign country. The promoter indicated that, for income tax purposes, the fair market value of the books is their established retail price in the foreign country. After holding the books for 13 months, Tom gave them to several charities and claimed a $10,000 ($100 a book) charitable deduction on his income tax return. The list price of the books in the foreign country is not enough to support the deduction claimed by Tom.

Because Tom's activities are equivalent to the selling activities of a book dealer, he is treated as having contributed ordinary income property. If the fair market value of the books at the time of the gift is determined to be $3,000, or $30 a book, Tom's deduction is limited to $2,500 (the fair market value, $3,000, minus $500, the amount that would be ordinary income). However, if the fair market value is determined to be $1,000, or $10 a book, Tom's deduction is limited to $1,000, the fair market value.

This rule applies to any property donated under similar circumstances.

***Depreciable property.*** If you give depreciable property to a qualified organization, you must reduce its fair market value by the amount of the gain that would be ordinary income, because of the depreciation taken, if the property had been sold. See Publication 544, *Sales and Other Dispositions of Assets*, for the kinds of depreciable property to which this rule applies.

There are special rules for corporations (other than subchapter S corporations) that contribute certain kinds of ordinary income property, such as inventory, to public charities or private operating foundations. For more information, see Publication 542, *Tax Information on Corporations.*

**Capital gain property** is property that would result in long-term capital gain if you sold it at fair market value on the date of contribution.

***The maximum amount of the deduction*** is usually the fair market value of the property. But you must reduce the fair market value of capital gain property by 40% of the increase in value if:

1) The contributed capital gain property is ***tangible personal property*** and the charity's use of the property is unrelated to its exempt purpose or function. For example, soon after a bust is given to a museum, the museum sells it at auction, or
2) The capital gain property is given to certain private nonoperating foundations.

In addition, you may choose to reduce the amount of the contribution by 40% of the long-term capital gain. This choice may benefit you because of rules on deduction limitations and carryovers to later years.

For more information on gifts of appreciated property and special limits that may apply, see Publication 526, *Charitable Contributions.*

## Contributions Related to Your Business

If you can deduct only part of your allowable contribution because of the percentage limits, the dollar limits, or the requirements as to the time of payment, you may not deduct the remainder as a business expense.

***Example.*** You give property worth $5,000 to a qualified organization but you can deduct only $4,000 as a charitable contribution because of the various limits and requirements that apply to charitable contributions. You may not deduct the remaining $1,000 as a business expense. However, see *Inventory*, discussed later.

**Limits on business expense deductions.** The limit on business expense deductions applies only if the contribution or gift is, in fact, a charitable contribution. If your transfer of property to a qualified organization is directly related to your business and you make the transfer with reasonable expectation of a financial return equal to the value of the property transferred, the transfer may be an allowable business expense rather than a charitable contribution.

***Example.*** Jim Wilson owns a furniture store. Jim gives furniture and equipment held for sale to the local hospital (a qualified organization). In return, the hospital signs an agreement to provide medical services and facilities for Jim's employees. The transfer is not a charitable contribution. If it otherwise qualifies, the cost of the goods delivered may be deducted as a business expense.

## Transfer of Land to a Governmental Body

If you transfer part of your land to a governmental body (state, county, etc.) to get approval of your plans to subdivide the remaining land, you have not made a charitable contribution. However, you may add your basis (generally your cost) in the transferred land to your basis in the remaining land.

**An open space or scenic easement** given in perpetuity to a governmental body or qualified organization without expectation of economic benefit is a deductible charitable contribution. In addition, a donation of an open space easement in gross, in perpetuity in property that is a capital asset held for more than one year qualifies as ***capital gain property.***

The amount of the deduction is the difference between the fair market value of the ***entire*** property before the easement is granted and the ***entire*** property after the easement is granted.

***Example 1.*** You own 10 acres of farmland. Similar land in the area has a fair market value of $2,000 an acre. However, land in the general area that is restricted solely to farm use has a fair market value of $1,500 an acre. Your county wants to preserve open space and prevent further development in your area.

You grant to the county an enforceable open space easement in perpetuity on 8 of the 10 acres, restricting its use to farmland. The value of this easement is $4,000, determined as follows:

| | | |
|---|---|---|
| Fair market value of the entire tract before granting easement: | | |
| $2,000 × 10 acres | | $20,000 |
| Fair market value of the entire tract after granting easement: | | |
| $1,500 × 8 acres | $12,000 | |
| $2,000 × 2 acres | 4,000 | 16,000 |
| Value of easement | | $ 4,000 |

If you later transfer in fee your remaining interest in the 8 acres to another qualified organization, you must consider the easement in determining the fair market value of the remaining interest.

***Note:*** Granting an easement on part of your property can affect the value of your remaining property.

***Example 2.*** You contribute an easement in perpetuity in a 50-acre tract of vacant beachfront property to a city government. The deed provides that you will keep the mineral rights to the property, have a right of access to the open water, and have access to a usable channel through the property to bordering land.

The deed also specifies that you will be responsible for the taxes, levies, and assessments, in connection with the property.

The transaction qualifies as a contribution of an open space easement and you may claim a charitable contribution deduction for the value of the restricted easement.

## Benefits to Donors

If you expect to receive money or other benefits in return for making a gift to a qualified organization, and the value of the benefit is equal to the value of your gift, you have not made a charitable contribution.

***Example.*** You transfer real estate to a nursing home in return for a promise of permanent care for your father. You have not made a charitable contribution because you have received a valuable consideration (permanent care for your father) for making the gift.

## Installment Obligations

A gift of installment obligations is deductible. The amount of the deduction is the fair market value of the obligations at the time of the gift *if* the difference between the basis of the obligations and their fair market value is included in income at the time of the gift. The gain may be ordinary income or capital gain, and the loss may be deducted if the property sold was held for business purposes.

**Installment obligations** are those received in a transaction that qualifies for the installment sales method of reporting. The gain or loss is considered to result from the sale or exchange of the property on which the obligations were received.

***Example.*** You sold your home 2 years ago for $60,000. You did not buy or build a new home and you are not eligible for the one-time exclusion of gain from the sale of a principal residence (your home). Six years ago, your home cost you $30,000. When you sold it, you received $15,000 in cash and the buyer's note secured by a mortgage for the remainder, payable in later years. Last year, before the buyer made any more payments on the note, you gave the note and the mortgage to your church. At that time they had a fair market value of $39,000. You may deduct the $39,000 as a charitable contribution. You must also include $16,500 in your income, before the capital gain deduction, figured as follows.

| | | |
|---|---|---|
| Fair market value of note at time of gift | | $39,000 |
| Selling price of home (also contract price) | $60,000 | |
| Minus basis (cost of house) | 30,000 | |
| Profit to be realized on sale | $30,000 | |
| Percentage of profit, or part of each collection you must report as income (under installment method), $30,000 divided by $60,000, 50%. | | |
| Unpaid balance of note | $45,000 | |
| Amount of income you would report if the note were paid in full, 50% of $45,000 | 22,500 | |
| Adjusted basis of note: Excess of unpaid balance of note over amount of income you would report if note were paid in full | | 22,500 |
| Income realized on disposition (gift) of installment obligation | | $16,500 |

You report the $16,500 as a long-term capital gain, because the home was a capital asset in your hands, held more than one year.

## Letters and Memorandums

Letters, memorandums, or similar property given to a charity by the person who created them or the person for whom they were created, or by the person to whom they were addressed, are considered ***ordinary income property.*** The deduction is limited to the fair market value of the property reduced by the amount of appreciation over the cost or other adjusted basis of the property.

***Similar property*** includes a draft of a speech, a manuscript, a research paper, an oral recording of any kind, a transcript of an oral recording, a transcript of an oral interview or of dictation, a personal or business diary, or a log or a journal. In addition, a corporate archive, including a corporate charter, office correspondence, a financial record, a drawing, a photograph, or a dispatch is considered to be similar property.

These rules do not apply to corporate archives, records, or correspondence sold or disposed of as part of a going business if there is no significant value other than its relation to, and use in, the business.

Generally, property is created by the personal efforts of an individual who performs literary, theatrical, musical, artistic, or other work that effectively contributes to creating the property, or by an individual who directs and guides the performance of others.

A letter, memorandum, or similar property that is prepared by personnel who are under the administrative control of an individual, such as a corporate executive, is considered to have been prepared or produced by the executive, whether or not the material is reviewed by that person.

## Government Publications

U.S. Government publications (including the *Congressional Record*) that you get from the Government without charge, or below the price at which they are sold to the general public, are considered ***ordinary income property.*** If you later give these publications to a qualified organization, your deduction is the fair market value minus the amount that would be ordinary income if you had sold them at fair market value.

If you receive, without charge, any Government publications from someone who received them without charge, or below the price at which they are sold to the general public, your basis in the publications, for tax purposes, is the same as that of the person who originally received them.

## Donating the Use of Your Property

If you let a charitable organization use your property, you may not deduct the rental value of its use. For example, you may not deduct the rental value of the use of your land by a church for a picnic.

## Donating a Future Interest in Tangible Personal Property

A future interest is an interest in property that is to begin in use, possession, or enjoyment at some future time. It is not necessary that the interest be designated as a future interest under state law.

**When deductible.** A gift of a future interest in tangible personal property to a qualified organization may not be deducted until all intervening interests in, and rights to, the actual possession or enjoyment of the property have either expired or are held by someone other than yourself or a ***related person.***

As used here, ***tangible personal property*** includes a fixture, such as a chandelier, that can be removed from the real property and donated separately.

**The amount of the contribution** is the value of the future interest when the intervening interests have expired. The valuation of future interests in property is discussed later under *Annuities, Terms for Years, Remainders, and Reversions.*

***Example 1.*** You agree to lend your collection of rare coins for an exhibit by a nonprofit museum. Under the terms of the agreement, you may take back the collection at any time before your death. At that time the collection will pass to the museum, a qualified charitable organization.

Because this collection of rare coins is not held primarily as a medium of exchange and has increased in value as a collector's item, the collection is tangible personal property. A charitable contribution was ***not*** made at the time it was placed on exhibit.

***Example 2.*** You transferred a painting to your son for your life and then to the local art museum upon your death. If your son irrevocably transfers his life interest to a friend in a later year, you may take a charitable deduction in that year, but not sooner. The amount of your deduction is the value of the future interest in the painting in the year your son transfers his interest to his friend.

**Related persons** include the following:

1) You and the members of your family—this includes only your brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.),
2) You and a corporation in which you own, directly or indirectly, more than 50% of the stock,
3) A trust fiduciary and a corporation of which more than 50% of the stock is owned, directly or indirectly, by or for the trust or by or for the grantor of the trust,
4) The grantor and fiduciary, and the fiduciary and beneficiary, of any trust,
5) The fiduciaries of two different trusts, and the fiduciary and beneficiary of two differ-

ent trusts, if the same person is the grantor of both trusts, and

6) You and an exempt educational or charitable organization that is controlled by you or a member of your family.

***Indirect ownership of stock.*** In determining whether you own, directly or indirectly, any of the outstanding stock of a corporation, the following applies:

1) If stock is owned directly or indirectly by or for a corporation, partnership, estate, or trust in which you are a shareholder, partner, or beneficiary, you are treated as the owner in proportion to your ownership interest.
2) If stock is owned directly or indirectly by or for a member your family (as defined under *Related persons*), it is considered to be owned by you.
3) If you and another member of a partnership each own stock in the same corporation (directly or indirectly), you are treated as owning each other's stock. However, this does not apply for stock one of you owns because of the rule in (2).

Stock constructively owned by a person under (1) is treated as actually owned by that person, for applying (1), (2), or (3). But stock constructively owned by a person under (2) or (3) is not treated as owned by that person for again applying either (2) or (3) to make another the constructive owner of the stock.

### Remainder Interest in Real Property

Generally, a remainder interest in real property must be transferred to certain charitable trusts to qualify for a charitable deduction. However, an exception to this rule is an irrevocable gift of a remainder interest in a personal residence or farm. (See also *Transfer of partial interest in property for conservation purposes.*)

For example, you give your home (or farm) to your church, but keep the right to live there for life, or for a specified number of years. You have made a charitable gift of a remainder interest.

**Valuation of a remainder interest in real property, not transferred in trust.** The amount of the deduction for a donation of a remainder interest in real property is the fair market value of the remainder interest at the time of the contribution. Depreciation (figured by the straight line method) and depletion (figured by the cost depletion method) must be considered in determining the fair market value. This value must be reduced at the rate of 6% a year, or at some other rate set by the government.

If the remainder interest includes both depreciable and nondepreciable property, for example a house and land, the fair market value must be allocated between each kind of property at the time of the contribution. This rule also applies to a gift of a remainder interest that includes a property that is part depletable and part not depletable. Depreciation or depletion will be taken into account only for the property that is subject to depreciation or depletion.

The value of a remainder interest following only one life is figured under the rules of section 1.170A-12(b) of the Income Tax Regulations. The value of a remainder interest following a term for years is determined under section 1.170A-12(c) of the Regulations. The value of a remainder interest dependent on the continuation or the termination of more than one life or on a term certain concurrent with one or more lives is figured under section 1.170A-12(e) of the Regulations. You may inspect the Income Tax Regulations at your Internal Revenue office. You may also get additional information regarding the valuation of a remainder interest in real property at that office.

**Transfer of partial interest in property for conservation purposes.** A lease, option to buy, or an easement on real property given in perpetuity to a charitable organization exclusively for conservation purposes after June 13, 1977, and before June 14, 1981, is deductible as a charitable contribution. In addition, a remainder interest in real property given to a charitable organization exclusively for conservation purposes after June 13, 1976, and before June 14, 1981, is also deductible as a charitable contribution.

***Conservation purposes*** means the preservation of land areas for public outdoor recreation or education, or scenic enjoyment, the preservation of historically important land areas or structures, or the protection of natural environmental systems.

## Problems in Determining Fair Market Value

There are a number of pitfalls to be avoided in determining the value of donated noncash property. A few of the more common ones follow.

### Fixed Formulas, Rules, or Methods

Finding the value of donated property would be a simple matter if the appraiser could rely only on fixed formulas, rules, or methods. Usually it is not that simple. Using such formulas, etc., seldom results in an acceptable determination of fair market value. There is no single formula that always applies when determining the value of property. This is not to say that a valuation is only guesswork. The appraiser must consider all the facts and circumstances connected with the property, such as its desirability, use, and scarcity. For example, donated furniture should not be evaluated at some fixed rate such as 15% of replacement cost new. When the furniture is contributed it may be out of style or in poor condition. It would have little or no market value. On the other hand, it may be an antique, whose value could not be determined by using any formula.

### Unusual Market Conditions

The sale price of the property itself in an arm's length transaction in an open market is often the best evidence of its value. When sales of comparable property are relied on, the sales must have been made in an open market. If those sales were made in a market that was artificially supported or stimulated so as not to be truly representative, the prices at which the sales were made will not indicate the fair market value. For example, liquidation sale prices usually do not indicate the fair market value. Also, sales of stock under unusual circumstances, such as sales of small lots, forced sales, and sales in a restricted market, may not represent the fair market value.

### Future Events

Unexpected events happening after your donation of property may not be considered in making the valuation. You may only consider the facts known at the time of the gift, and those that could be reasonably expected at that time.

***Example.*** You give farm land to a qualified charity. The transfer provides that your mother will have the right to all income and full use of the property for life. Even though your mother dies one week after the transfer, the value of the property on the date it is contributed is its present value, subject to the life interest as estimated from mortality tables. You may not take a higher deduction because the charity received full use and possession of the land only one week after the transfer.

### Careless Selection of Comparable Sales

Using sales of comparable property is an important method for determining the fair market value of donated property. However, the amount of weight given to a sale depends on the degree of similarity between the comparable and the donated properties. The degree of similarity must be close enough so that this sales price would have been given consideration by reasonably well-informed buyers or sellers of the property.

***Example.*** You give a rare old book to your former college. The book is a third edition and is in poor condition because of a missing back cover. You discover that there was a sale for $300, near the valuation date, of a first edition of the book that was in good condition. Although the contents are the same, the books are not at all similar because of the different editions and the physical condition of the two books. The sale price of the comparable property would be given little consideration by knowledgeable buyers or sellers.

### Using Past Events to Predict the Future

A common error is to rely too much on past events to predict future earnings and fair market value.

***Example.*** You give all your rights in a successful patent to your favorite charity. Your records show that before the valuation date there were three stages in the patent's history of earnings. First, there was rapid growth in earnings when the invention was introduced. Then, there was a period of high earnings when the invention was being exploited. Finally, there was a decline in earnings when competing inventions were introduced. While the entire history of earnings may be relevant in estimating the future earnings, the appraiser must not rely too much on the stage of rapid growth in earnings, or of high earnings. The market conditions at those times do not represent the condition of the market at the valuation date. What is most significant is the ***trend of decline*** in earnings up to the valuation date.

## Information on the Return—Appraisals

If you donate property other than cash, you must attach a statement to your return describing the property contributed and the date of the gift. Also show how the fair market value was figured and whether the amount of your gift was reduced by any increase in value, explained earlier under *Gifts of Appreciated Property.*

In addition, for each gift of property for which you claim a deduction of more than $200, the statement you attach to your return must give the following information:

1) The name and address of the organization you made the contribution to.
2) The date of the actual contribution.
3) A description of the property contributed in enough detail to identify it including, for tangible property, its physical condition at the time of the contribution. For securities, give the name of the issuer, the kind of security, and state whether the security is regularly traded on a stock exchange or in an over-the-counter market.
4) The approximate date you received the property, and how you acquired it (by purchase, gift, etc.).
5) The fair market value of the property at the time you made the contribution, showing how you determined its fair market value. If it was determined by appraisal, attach a signed copy of the appraiser's report.
6) The cost or other adjusted basis of property, other than securities, held for a period of less than 5 years immediately before the date on which the contribution was made. If available, include the cost or other adjusted basis of property, other than securities, held for a period of at least 5 years before the date on which the contribution was made.
7) The amount and computation of the reduction of the charitable contribution for certain amounts that you would report as ordinary income had you sold the property at its fair market value—
   a) For certain appreciated property, see Publication 544, *Sales and Other Dispositions of Assets,*
   b) For certain kinds of mining property, include the deductions taken for certain exploration expenses.
8) The terms of any agreement or understanding entered into by you, or on your behalf, relating to the use, sale, or other disposition of the property. Write out the terms of any agreement or understanding that restricts the charitable organization's use of the contributed property. Indicate whether the property has a particular use, such as the use of donated furniture in the reading room of the organization's library.
9) The total amount you claimed as a deduction in the tax year you contributed the property. If you contribute less than the entire interest in the property during the tax year, give the amount claimed as a deduction in any earlier years for contributions of other interests in the property. Include the name and address of the organization you made the contribution to, the place where the property (if tangible property) is located or kept, and the name of the person who has possession of the property, if other than the organization to which you gave the property.

### Appraisals

Appraisals are not always necessary, particularly for minor items of property. This is also true when the value of the property can easily be determined, such as the prices of securities that are reported daily in the newspapers.

If you find it necessary to hire an appraiser to determine the value of your donated property, include the appraisal report with your return. The more complete the information in the report, the less likely it will be for the Internal Revenue Service to question items in it.

**The weight given the appraisal** depends on the completeness of the report, the qualifications of the appraiser, and the appraiser's knowledge of the donated property. A satisfactory appraisal gives all the facts on which to base an intelligent judgment of the value of the property. Appraisals should be made as close to the valuation date as possible.

The appraisal may not be given any weight if:

1) All the factors that apply are not considered,
2) The opinion is not supported with facts, such as purchase cost and comparable sales, or
3) The opinion is not consistent with known facts.

**The appraiser.** The appraiser's opinion is never more valid than the facts on which it is based; without these facts it is simply a guess.

Membership in professional appraisal organizations does not automatically establish the appraiser's competency. Nor does the lack of certificates, memberships, etc., automatically take away from the competency of the appraiser.

An appraisal may be given less weight if the appraiser is associated with either the donor or the charitable organization. Such an appraisal might be highly inflated. The opinion of a person claiming to be an ***expert*** is not binding on the Internal Revenue Service. All the facts associated with the donation may be considered.

**Cost of appraisals.** You may not take a charitable deduction for fees you pay for appraisals of your donated property. However, they may qualify as a miscellaneous deduction on Schedule A (Form 1040) if they were paid to determine the amount allowable as a charitable contribution.

### Appraisal Format

In general, an appraisal report should include at least the following:

1) A summary of the appraiser's qualifications to appraise property of this kind and price range.
2) A statement of the value and the appraiser's definition of value and reason for the appraisal.
3) A full description of the item to be valued.
4) The basis on which the appraisal was made, including restrictions, understandings, or agreements or obligations limiting the use or disposition of the property.
5) The effective date of the valuation. (The date the organization formally accepted the property should be used.)
6) The signature of the appraiser, the dates the property was inspected, and the date the report was signed.

**An example** of the kind of data that should be included in a typical appraisal follows. This example deals with the valuation of art or antiques, but the same kind of detailed information should be given for other property. Appraisal of art objects, paintings in particular, should include:

1) A complete description of the object, indicating the size, the subject matter, the medium, the name of the artist, and approximate date created.
2) The cost, date, and how it was acquired.
3) A history of the ownership and public exhibitions of the item including proof of authenticity—such as a certificate of authenticity and citations in literature.

4) A photograph of a size and quality fully showing the object, preferably an 8" × 10" or larger print, or color transparency.
5) The facts on which the appraisal was based, such as—
   a) Sales or analyses of similar works by the artist, particularly on or around the valuation date,
   b) For living artists, prices in dealer's catalogs of the artist's works,
   c) The state of the art market at the time of valuation, particularly with respect to the specific artist, school, or price range.
6) The interests (life interest, reversionary interest, etc.) transferred and those kept.

Although an appraisal report meets these requirements, the Internal Revenue Service still has the responsibility of reviewing the appraisal if it is necessary.

### Internal Revenue Service Review of Appraisals

In reviewing an income tax return, the Service may accept the claimed value of the donated property, based on information or appraisals sent with the return. Or the Service may make its own determination of fair market value. In either case, the Service may:

1) Contact the taxpayer to get more information,
2) Refer the valuation problem to a Service appraiser or valuation specialist,
3) Refer the issue to the Commissioner's Art Advisory Panel. This is a twelve member group of dealers and museum directors who review and recommend acceptance or adjustment of taxpayers' claimed values for major paintings, sculptures, or antiques, or
4) Contract with an independent dealer, scholar, or appraiser to appraise the property. (This may be done by the Service when the objects require appraisers of highly specialized experience and knowledge.)

The Service is responsible for reviewing appraisals, but it is not responsible for making them. Supporting the fair market value listed on your return is your responsibility.

**The Service does not give recognition** to any appraiser or organization of appraisers and accept their appraisals without question.

**The Service does not approve valuations or appraisals before the actual filing** of the tax return to which the appraisal applies. In addition, the Service does not issue advance rulings approving or disapproving such appraisals.

## Valuation of Various Kinds of Property

The beginning of this publication discusses, in general, the rules and requirements for making and proving the valuation of any donated property. Following is information on determining the fair market value of ordinary kinds of donated property.

### Household Goods

The fair market value of used household goods, such as furniture, appliances, and linens, is usually much lower than the price paid when new. Such used property may have little or no market value because of its worn condition. It may be out of style or no longer useful. For these reasons, formulas, such as 15% of the replacement cost new, do not apply in determining value.

In supporting the claimed value, you should include the appraisal with your return. If there is no appraisal, you should support your valuation with photographs, cancelled checks, or receipts from your purchase of the items. Magazine or newspaper articles and photographs that describe the items and statements by the recipients of the items are also useful or important.

If the property is valuable because it is old or unique, see the discussion under *Paintings, Antiques, Other Objects of Art.*

### Used Clothing

Used clothing and other personal items such as household goods, are usually worth far less than the price you paid for them. Valuation of items of clothing does not lend itself to fixed formulas or methods.

You should report a value equal to the price buyers of such used items actually pay in used clothing stores, such as consignment or thrift shops.

For valuable furs or very expensive gowns, an appraisal should be sent with your tax return.

### Jewelry and Gems

Jewelry and gems, other than "costume" jewelry, are of such a specialized nature that it is almost always necessary to get an appraisal by a specialized jewelry appraiser. The appraisal should describe, among other things, the style of the jewelry, the cut and setting of the gem, and whether it is now in fashion. If not in fashion, the possibility of having the property redesigned, recut, or reset should be reported in the appraisal. The stone's coloring, weight, cut, brilliance, and flaws should be reported and analyzed. Sentimental personal value has no effect on fair market value. But if the jewelry was owned by a famous person, its value might increase.

### Paintings, Antiques, Other Objects of Art

Unless the item being evaluated is minor, your deduction should be supported by a written appraisal from a qualified and reputable source. An example of the information that must be included in appraisals of art objects, paintings in particular, may be found under *Appraisal Format.*

**Most art appraisers are not experts on all art.** More weight will usually be given to an appraisal prepared by an individual specializing in the kind and price range of the art being appraised. For example, certain art dealers or appraisers specialize in 19th century French old master oil paintings and bronze sculpture. Their opinions on the authenticity and desirability of such art would usually be given more weight than the opinions of more generalized art dealers or appraisers. They can report more recent, comparable sales to support their opinion.

***The authenticity*** of the donated art must be determined by the appraiser. Certificates of authenticity may be useful but this depends upon the genuineness of the certificate and the qualifications of the authenticator.

**An important item in the valuation of antiques and art is physical condition and extent of restoration.** These have a significant bearing on the value, and must be fully reported in an appraisal. An antique in damaged condition, or lacking the "original brasses," may be worth much less than a similar piece in excellent condition.

To identify and locate experts on unique, specialized items or collections, you may wish to use the current *Official Museum Directory* of the American Association of Museums. It has both a subject category and geographic index.

*The Encyclopedia of Associations,* Gale Research Company, is another useful starting point, particularly section 5, which describes educational organizations. Section 6 describes cultural organizations. Section 13 describes over 450 national hobby and avocational organizations, including various highly specialized private collector groups. It also has an alphabetical and key word index. These books may be available at a state, city, college or museum library.

To help you locate a qualified appraiser for your donation, you may wish to ask an art historian at a nearby college or the director or curator of a local museum. The yellow pages often list specialized art and antique dealers, auctioneers, and art appraisers. Associations of dealers also may be contacted for guidance.

### Collections

So many kinds of hobby collections may be the subject of a charitable donation that it is not practical to discuss them all in this publication. Most common are: rare books, autographs, manuscripts, stamps, coins, guns, phonograph records, and natural history items. Many of the elements of valuation that apply to paintings and other objects of art, discussed earlier, also apply to miscellaneous collections.

***Reference material.*** Publications available to help you determine the value of many kinds of collections include catalogs, dealers' price lists, and specialized hobby periodicals. However, these sources are not always reliable indicators of fair market value.

For example, a dealer may sell an item for much less than shown on a price list, particularly after the item has remained unsold for a long time. The price an item sold for in an auction may have been the result of a rigged sale or a mere bidding duel. The appraiser must analyze the reference material, and recognize and make adjustments for misleading entries. If you are donating a valuable collection, you should get an appraisal. If your donation appears to be of little value, you may be able to make a satisfactory valuation using reference materials available at a state, city, college or museum library. If your local library does not have the necessary material, your librarian can often order it from the city or state library systems.

**Stamp collections.** Most libraries have catalogs or other books that report the publisher's estimate of values. Generally, two price levels are shown for each stamp; the price postmarked, and the price not postmarked. Stamp dealers generally know the value of their merchandise and are able to prepare satisfactory appraisals of valuable collections.

**Coin collections.** Many catalogs and other reference materials show the current value of coins. Like many other collectors' items, the value of a coin depends on the demand for it, its age, and its rarity. Another important factor is its condition. There is a great difference in the value of a coin that is in ***proof condition*** and the same coin that is only in ***good condition.*** Coin collectors usually fill in their collection with coins in the best condition they can afford.

For example, coins in poor condition, or even fair condition, usually are turned down by collectors. Catalogs often grade the condition of a coin—proof, uncirculated, extremely fine, very fine, fine, very good, good, fair, or poor, with a different valuation for each category. Coin dealers should be able to authenticate, grade,and analyze these and other factors relating to value.

**Books.** The value of books is usually determined by selecting comparable sales and adjusting the prices according to the differences between the comparable sales and the item being evaluated. This is difficult to do and, except for a collection of little value, should be done by a specialized appraiser. Within the general category of literary property, there are dealers who specialize in certain areas, such as Americana, foreign imports, Bibles, and scientific books.

***If the collection you are donating is of modest value,*** not requiring a written appraisal, the following information may help you in determining fair market value.

A book that is very old, or very rare, is not necessarily valuable. There are many books that are very old or rare, but that have little or no market value. The serious collector is willing to pay "good money" for important books—rare books that are of great literary, scientific, historical, or other significance.

***The condition of a book*** has a great deal of influence on its value. Collectors are interested in items that are in fine, or at least good condition. When a book has a missing page, a loose binding, tears, stains, or is otherwise in poor condition, its value is greatly diminished.

***Some other important factors*** in the valuation of a book are the kind of binding (leather, cloth, paper), page edges, and illustrations (drawings and photographs). Collectors usually want first editions of books. However, because of changes or additions, other editions are sometimes worth as much as, or more than, the first edition.

**Manuscripts, autographs, diaries, and similar items,** that are handwritten, or at least signed, by famous people, often are in demand and are valuable. The writings of unknowns also may be of value if they are of unusual historical or literary importance. Determining the value of such material is difficult. There may be a great difference in value between two diaries that were kept by a famous person—one kept during childhood and the other during an important period in his or her life. The appraiser determines a value in these cases by applying knowledge and judgment to factors, such as comparable sales and conditions.

**Signatures,** or sets of signatures, that were cut from letters or other papers, usually have little or no value. But complete sets of the signatures of U.S. Presidents are in demand.

## Cars, Boats, and Aircraft

If you are not a dealer in cars, boats, or aircraft, and you give such property to a charitable organization, its fair market value must be determined.

Certain commercial firms and trade organizations publish, for different regions of the country, monthly or seasonal, complete dealer sale prices or dealer-average-prices. These are reported for each make, model, and year of used cars, aircraft, trucks, recreational vehicles, and boats. These guides also provide estimates for adjusting for unusual equipment, unusual mileage, and for physical condition. The prices are not "official" and these publications are not considered an appraisal of any specific donated property. But they do provide clues for making an appraisal and suggest relative prices for comparison with current sales and offerings in your area.

These publications are usually available from the loan officer at a bank, credit union or finance company.

Except for inexpensive small boats, the valuation of boats should be based on an appraisal by a marine surveyor. Some dealers are familiar with current market prices and may be good sources for appraisals.

## Inventory

If you donate inventory (property that you sell in the course of your business), the fair market value is the price that you would have received if you had sold the contributed property in the market in which you usually sell, at the time and place of the contribution. For a donation of goods in quantity, the fair market value is the price for the quantity contributed. The usual market of a manufacturer or other producer is the group of wholesalers or other distributors to or through whom sales usually are made. However, if sales are made only at retail, the usual market is the retail customer.

If you donate inventory at a time when you reasonably could not expect to get its usual selling price, the value of the gift is not the usual selling price but is the amount that you could have sold the property for at the time of the contribution.

**Costs and expenses relating to the contributed inventory** that were incurred in earlier tax years and are properly included in the opening inventory for the year of the contribution must be removed from inventory. In addition, these costs and expenses are not to be considered as part of the cost of goods sold in determining gross income for the year of contribution. Instead they are considered in determining the basis of the contribution.

However, any costs or expenses for the contributed inventory, which are incurred in the year of the contribution, that would be properly included in the cost of goods sold, should be included in costs of goods sold and are not considered in arriving at the basis for the property. The treatment is the same for the current year's deductible expenses and costs for the contributed inventory, even though not includible in the cost of goods sold.

## Stocks and Bonds

The value of stocks and bonds is the fair market value of a share or bond on the valuation date (see *Time of Contribution,* earlier).

**Based on selling prices.** If there is a market for the contributed stocks or bonds on a stock exchange, in an over-the-counter market, or elsewhere, the mean (midpoint) of the highest and lowest quoted selling prices on the valuation date is the fair market value of each share or bond.

If there were no sales on the valuation date, but there were sales within a reasonable period before and after the valuation date, the fair market value is determined by taking a weighted average of the means between the highest and lowest sales prices on the nearest date before, and the nearest date after the valuation date. The average is to be

weighted in ***inverse*** order by the respective number of trading days between the selling dates and the valuation date.

***Example.*** You give stock to a qualified organization on Wednesday, August 6. There were no sales of the stock on that day. Sales of the stock nearest the valuation date took place two trading days before, Monday, August 4, and three trading days after, Monday, August 11 (Saturday and Sunday were not trading days). On August 4, the highest selling price for a share was $11, and the lowest, $9. On August 11, the highest selling price for a share was $16, and the lowest, $14. The fair market value is $12, figured as follows:

($11 + $9) ÷ 2 = $10 Mean price on August 4

($16 + $14) ÷ 2 = $15 Mean price on August 11

[(3 × $10) + (2 × $15)] ÷ 5 = $12

***Stocks or bonds listed on more than one stock exchange*** are valued based on the prices of the exchange where they are principally dealt in. If these prices are not published in a generally available listing or publication of general circulation and the stocks or bonds are reported on a composite listing of combined exchanges in a publication of general circulation, the composite list is used. See also *Unavailable prices or closely held corporation.*

**Based on bid and asked prices.** If the rules under *Based on selling prices,* do not apply because there were no actual sales within a reasonable period before and after the valuation date, the fair market value is the mean between the bona fide bid and asked prices on the valuation date. If there were no prices available, the value may be determined by taking a weighted average of the means between the bona fide bid and asked prices on the closest trading date before and after the valuation date. Both dates must be within a reasonable period. The average should be weighted in ***inverse*** order by the respective number of trading days between the bid and asked dates and the valuation date.

***Example 1.*** Although there were no sales of Blue Corporation stock on the valuation date, bona fide bid and asked prices were available on that date of $14 and $16, respectively. The fair market value is $15, the mean between the bid and asked prices.

***Example 2.*** You made a donation of shares in the Black Corporation on Wednesday, September 10. No bid and asked prices were available. On Wednesday, September 3, five trading days before the valuation date (Saturday and Sunday were not trading days), the bid and asked prices were $26 and $30, respectively. On Friday, September 12, two trading days after the valuation date, the bid and asked prices were $19 and $23, respectively. The fair market value of a share is $23, figured as follows.

($26 + $30) ÷ 2 = $28 Mean price on September 3

($19 + $23) ÷ 2 = $21 Mean price on September 12

[(2 × $28) + (5 × $21)] ÷ 7 = $23

**If no actual sale prices** or bona fide bid and asked prices are available on a date within a reasonable period before the valuation date, but are available on a date within a reasonable period after the valuation date, or vice versa, then the mean between the highest and lowest of such available sale prices, or bid and asked prices, may be taken as the value.

**Large blocks of stock.** There is a basic economic principle that, when the supply is greater than the demand, prices will be lower. For example, if an unusually large block of stock is to be valued and the market price is based on sales in small quantities, the stock to be valued often is considered to be worth less. This economic rule is known as blockage. There are many factors to be considered in determining the amount of the discount, if any, usually requiring the help of experts specializing in underwriting large quantities of securities, or trading in the securities of the industry of which a particular company may be a part.

**Unavailable prices or closely held corporation.** If selling prices or bid and asked prices are not available, or if securities of a closely held corporation are involved, the fair market value is to be determined by taking into consideration the following factors:

1) For bonds, the soundness of the security, the interest yield, the date of maturity, and other relevant factors, and
2) For shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

***Some other relevant factors*** are the goodwill of the business, the economic outlook in the particular industry, the company's position in the industry, and the value of securities of corporations engaged in the same or similar business. Complete financial and other data on which the valuation is based should be sent with the return, including copies of reports of examinations of the company, made on or close to the valuation date, by accountants, engineers, or any technical experts.

## Real Estate

As each piece of real estate is unique and its valuation is complicated, a detailed appraisal by a professional appraiser is necessary.

Appraisers should be thoroughly trained in the application of appraisal principles and theory. This is true, whether or not they live in the community where they are appraising. There will be instances, however, when the opinions of equally qualified appraisers may carry unequal weight—such as when the property is located in an area in which one of the appraisers lives. That appraiser may have a better personal knowledge of local business conditions by having participated in sales and purchases, or having actually bought and sold comparable properties, on or about the date of appraisal by or near the property to be appraised.

***Essential in any appraisal report is a complete description*** of the property, such as street address, legal description, lot and block number, as well as physical features. The use to which the property is put or its potential use for other purposes is also relevant.

**Usual valuation methods.** In general, competent real estate appraisers approach the valuation problems by considering, among other things, the following three broad approaches:

1) Comparable sales,
2) Capitalization of income, and
3) Replacement cost new or reproduction cost minus observed depreciation.

Each of these approaches is important enough to warrant an individual discussion. It should be recognized that the usual appraisal will reflect a combined use of the second and third methods rather than a strict adherence to one method only.

***1. Comparable sales***

The comparable sales method compares the donated property with several similar properties that have been sold. The sales prices, taking into account the differences in date of sale, size, condition, and location, would then indicate the estimated fair market value of the donated property.

When the comparable sales method is used to determine the value of ***unimproved real property,*** the appraiser should consider the following factors when inspecting the potential comparable property and the donated property:

1) Location, size, zoning or use restrictions,
2) Accessibility and road frontage, available utilities and water rights,
c) Riparian rights (right of access to and use of the water by owners of land on the bank of a river), existing easements, rights of way, leases, etc.,
4) Soil characteristics, vegetative cover, status of mineral rights, and
5) Other factors affecting value.

In addition, the names of the buyer and seller, the deed book and page number, the date of sale, sale price, property description, amount and terms of mortgages, property surveys, the assessed value, tax rate, and the assessor's appraised fair market value of the comparable properties should be indicated.,

The comparable sale price must be adjusted to account for differences between the sale property and the donated property. Because differences of opinions may arise between appraisers as to the degree of comparability and the amount of the adjustment considered necessary for comparison purposes, an appraiser should document each item of adjustment.

Only comparable sales having the least adjustments in terms of items and/or total dollar adjustments should be considered as comparable to the donated property.

***Unimproved real property*** is land without significant buildings, structures, or any other improvements that add to its value.

***2. Capitalization of Income***

This method capitalizes the net income from the property at a rate that represents a fair return on the particular investment at the particular time, considering the risks involved. The key elements are the determination of the income to be capitalized and the rate of capitalization.

***3. Replacement cost new or reproduction cost minus observed depreciation***

This method alone does not result in a determination of fair market value. When used, it generally tends to set the upper limit of value, particularly in periods of rising costs, because it is reasonable to assume that an informed buyer will not pay more for the real estate than it would cost to reproduce a similar property. Of course, this reasoning does not apply if a similar property cannot be created because of location, unusual construction, or some other reason. Generally, it serves to support the value. When the replacement cost method is applied to ***improved realty,*** the land and improvements are valued separately. This separate valuation is necessary when dividing the cost between the land and buildings for income tax purposes.

The replacement cost of a building is figured by using the number of square feet or cubic feet in the building. This cost represents the total cost of labor and material, overhead and profit. After the replacement cost has been figured, consideration must be given to the following factors:

1) Physical deterioration—the wear and tear on the building itself,
2) Functional obsolescence—usually in older buildings where, for example, there is inadequate light, plumbing, or heating, where rooms are small or the floor plan is poor, and
3) Economic obsolescence—outside forces causing the whole area to become less desirable.

## Interest in a Business

The fair market value of any interest in a business, whether a sole proprietorship or a partnership, is the net amount that a willing buyer would pay for the interest of a willing seller after consideration of all relevant factors. The relevant factors to be considered in valuing the business are:

1) The fair market value of the assets of the business,
2) The prospective earning capacity of the business, based on a review of past and current earnings, and
3) The other factors used in evaluating corporate stock, if they apply.

The value of the goodwill of the business should also be taken into consideration. Complete financial and other data on which the valuation is based should be sent with the return, including copies of reports of examinations of the business made, on or close to the valuation date, by accountants, engineers, or any technical experts.

## Annuities, Terms for Years, Remainders, and Reversions

The value of these kinds of property is their present value, except in the case of annuities under contracts issued by companies regularly engaged in their sale. The valuation of such commercial annuity contracts and of insurance policies is discussed later under *Certain Life Insurance and Annuity Contracts.* The special rule for *Donating a Future Interest in Tangible Personal Property* is discussed earlier in this publication.

**It is usually necessary to refer to actuarial tables** to determine your charitable deduction when annuities, income from trust property, or remainder interests are transferred to a charitable organization.

**The present value** of an annuity, remainder (other than those specified), or reversion that is dependent on the continuation or termination of the life of one person, is figured by the use of Table A(1) or A(2) in section 20.2031-10 of the Estate Tax Regulations. The present value of an annuity, term for years, remainder, or reversion that is dependent on a term certain is figured by the use of Table B in the above regulations.

The value of a remainder interest in a charitable remainder annuity trust is determined under section 1.664-2 of the Income Tax Regulations. The value of a remainder interest in a charitable remainder unitrust is determined under section 1.664-4 of the Regulations. The value of a remainder interest in a pooled income fund is determined under section 1.642 (c)-6 of the Regulations. You may inspect these at your Internal Revenue office.

If the valuation of the interest is dependent upon the continuation or termination of more than one life, or upon a term certain concurrent with one or more lives, a special factor must be used. Many of these factors may be found in, or can be figured with the use of Publications 723, 723A, and 723B, which you may buy from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

If a special factor is needed for an actual transaction, you may ask for the special factor by writing the Internal Revenue Service, Attention: T:I:EG, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Be sure to include the date of birth and sex of each person, the duration of whose life may affect the value of the interest, and copies of the relevant instruments.

In certain circumstances a charitable deduction may be allowed for the donation of a partial interest in property. For a more detailed discussion of contributions of partial interests in property, see Publication 526, *Charitable Contributions.*

## Certain Life Insurance and Annuity Contracts

The value of an annuity contract or a life insurance policy issued by a company regularly engaged in their sale is the amount that company would charge for a comparable contract.

But, if the donee of a life insurance policy may reasonably be expected to cash the policy rather than hold it as an investment, then the fair market value is the cash surrender value rather than the replacement cost.

If an annuity is payable under a combination annuity contract and life insurance policy (for example, a retirement income policy with death benefit) and there was no insurance element when it was transferred to the charity, the policy is treated as an annuity contract.

## Personal Services

You may not deduct the value of your ***time*** or ***services*** that you contribute to a qualified organization. For example, if you are a carpenter, you may not deduct the value of the time or services you give to make repairs on a church. Lawyers, doctors, mechanics, artists, etc., may not deduct the value of their donated time or services.

**Blood given** to the Red Cross or to other blood banks is not deductible.

**Newspapers donating space, or a radio or television station donating time,** to a charitable organization may not deduct the value of that space or time. They are providing services and not making a gift of property.

**An employer** may take a charitable deduction for wages paid to employees while they are giving services to a charity. However, the wages may not be deducted again as a business expense.

## Out-of-Pocket Expenses

Out-of-pocket expenses, which are not repaid to you, that you incur in donating services to a qualified organization without pay are deductible as a charitable contribution. This includes amounts you pay for transportation from your home to the place where you serve. In addition, reasonable payments for necessary meals and lodging while you are away from home overnight donating services to a qualified organization are deductible.

You should keep records and other written proof to support your deduction of out-of-pocket expenses. Estimates are not acceptable.

Expenses you incur to attend a church convention only as a member of your church, and not as a chosen representative, may not be deducted. However, you may deduct unreimbursed expenses that are directly connected

with a donated service you perform for your church during the convention.

***Example.*** If you are an elected delegate and you are not paid for your services while attending a convention held by a qualified organization, you may deduct as a charitable contribution your actual unreimbursed expenses for travel and/or transportation. If reasonable, you may also deduct amounts you incurred for meals and lodging while away from home overnight, in connection with the affairs of the convention. However, you may not deduct expenses for sightseeing, fishing parties, theater tickets, night clubs, or any other personal expenses. Moreover, the travel, meals and lodging, and any other expenses for your spouse, children, etc., are personal nondeductible expenses.

**Car expenses.** If you use your car in giving services without pay to a qualified organization, you may deduct a standard mileage rate of 9 cents a mile as a contribution. However, if your allowable transportation expenses are more than this rate, and if the organization did not pay you for these expenses, you may deduct your actual expenses for gas, oil, and other necessary items. Depreciation, insurance, and repairs on the car are not deductible. Parking fees and tolls may be deducted in addition to the standard mileage rate.

**Cost and upkeep of uniforms** that have no general use and are required to be worn while performing donated services are deductible.

**Pre-adoption expenses** you incur in adopting a child are not considered as made for the benefit of the charitable institution with which the child was placed for adoption, and may not be deducted as a contribution. However, the amount paid for medical services given directly to the child may, under certain circumstances, qualify as a medical expense deduction. Contact your Internal Revenue Service office if you want more information on this rule.

**Foster parents.** You may deduct unreimbursed expenses you pay to provide foster care for children placed in your home by a charitable organization.

**Keeping a student in your home.** You may deduct up to $50 a school month of the amount you paid to keep a student in your home. The student may be foreign or American and must be someone who is not your dependent or relative. The student must be a member of your household under a written agreement between you and a qualified organization. The purpose of the agreement must be to provide educational opportunities for the student.

The total amount you can deduct may not be more than $50 of your expenses for each full calendar month of your tax year during which the student is:

1) A member of your household, and
2) A full-time student in the 12th or lower grade at a school located in the United States.

A period of 15 or more days in a month is considered a full calendar month for this purpose.

If you receive any pay or are paid back for the costs of keeping a student in your home, you will not be allowed a deduction for any part of these costs. However, you may be able to take the deduction if you are repaid for an unusual item, such as hospital bill or vacation trip, that you paid in advance at the request of the student's parents or the sponsoring organization.

Depreciation on your home, and the fair market value of lodging or any similar item, is not considered an amount spent by you. You must actually spend money for the well-being of the student. Amounts you pay for books, tuition, food, clothing, and a reasonable amount for the entertainment of the student qualify for the deduction.

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